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# The Day the Music Died: Rooney, Pace and the Hostile Takeover of the Norlin Corporation

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The hostile takeover of the Norlin Corporation by Rooney, Pace is representative of the negative side of the merger and acquisition mania of the 1980s. Norlin was founded in 1913 as the Ecuadorian Corporation, a holding company for a brewery, cement plant, and other enterprises in Ecuador. In 1962 Hope Norton Stevens assumed the presidency and made the fateful decision to seek more profitable business opportunities in the United States. Between 1962 and 1966 the company acquired several electronics companies. In 1969 the Chicago Musical Instrument Company was acquired, and Norlin became the largest manufacturer of musical instruments in the United States. The early 1970s saw spectacular growth in the music business, but the 1975 recession forced the corporation to sell off both its remaining operations in Ecuador and its electronics units. In explaining the reasons for Norlin's takeover I emphasize the decision to acquire new lines of business for which Norlin's management lacked experience, the large amount of cash realized in the sale of Norlin's assets, its declining price-earnings ratio, and other factors. Finally, I analyze the unsuccessful defensive strategies employed by Norlin's management to block the hostile takeover by Rooney, Pace.

The hostile takeover is a particularly appropriate topic for this year's conference theme of "destruction and reconstruction" in business history. In this essay I present a case study of the hostile takeover of the Norlin Corporation by the Rooney, Pace Group in 1984 as an example of the

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destructive nature of the battles for corporate control characteristic of the decade of the 1980s.[1]

In 1962 Hope Norton Stevens assumed the presidency of the Ecuadorian Corporation, a company founded by his grandfather Evermont Hope Norton in 1913 as a holding company for a brewery and cement plant in Guayaquil and for utilities, real estate holdings, and various other enterprises in Quito, Ecuador.[2] Norton Stevens had joined the board of directors of the Ecuadorian Corporation upon graduation from Harvard Business School in 1958 and rapidly moved up the corporate ladder, becoming successively vice-president, executive vice-president, and president following the retirement and death of his grandfather in 1961.[3]

According to the Ecuadorian Corporation's 1960 annual report, the triumph of the Cuban Revolution on January 2, 1959, led the officers of the Ecuadorian Corporation, now known as ECL Industries, to assess the long-term future of the company's holdings in Ecuador. As a result of that assessment the board decided to diversify the company's assets by expanding into the United States, which would prove a safe haven should the political situation in Ecuador deteriorate.[4]

Electronics was identified as a profitable field of investment and, beginning in 1963, the corporation purchased controlling interests in four electronics firms, including the P. R. Hoffman Company of Carlisle, Pennsylvania, the A. D. Knapp Company of Mississippi in 1963, and the Superior Electronic Company of New Jersey in 1965. In 1966 the corporation purchased Howard Aiken Industries from Howard Aiken, one of the pioneers in the development of the computer industry.[5]

In 1969 ECL Industries purchased a majority stake in the Chicago Musical Instrument Company, the largest manufacturer of musical instruments in the United States and the owner of Gibson guitars, Lowrey organs, Story and Clark pianos, and Moog synthesizers, among others. ECL Industries shortly thereafter changed its name to the Norlin Corporation, a combination of Norton and Berlin, in honor of the founder of the Ecuadorian Corporation and of Maurice Berlin, the founder of the Chicago-based company.[6]

The acquisition of the Chicago Musical Instrument Company dramatically increased the value of the company's assets by 250 percent, from $52,848,778 in 1968 to $130,663,013 in 1969.[7] While the company's

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[1] See Patrick A. Gaughan, *Mergers, Acquisitions, and Corporate Restructurings* (New York, 1996), 18-24.

[2] John F. Uggen, "The Emergence of Multinational Enterprise in Ecuador: The Case of the Ecuadorian Corporation," *Business and Economic History On Line* 6 (2008): 10-11.

[3] The Ecuadorian Corporation, Ltd., *Annual Report* (1963).

[4] The Ecuadorian Corporation, Ltd., *Annual Report* (1960).

[5] ECL Industries, Inc., *Annual Report* (1969).

[6] Ibid., 9.

[7] Ibid., 20.

total assets increased steadily throughout the decade of the 1970s, reaching a peak in 1979 with $238,426,000 on its consolidated balance sheet, the company's music business suffered its first decline in 1975 as a result of the recession and subsequent drop in consumer spending.[8] The company's music unit, which averaged 60 percent of operating income for the period 1972-1974, saw its share of operating income fall to 15 percent in 1975. Ironically, the company's most profitable unit was the brewery in Ecuador, which accounted for an average of 40 percent of the company's income for the period and rose to 69 percent in 1975 to replace music as the leading unit of the company.[9]

The company's first major divestiture in Ecuador was the sale of 49 percent of its cement business in 1974 for $9 million in cash to the Corporación Financiera Nacional, Ecuador's national investment corporation. Two years later the company sold the remaining 51 percent for $11 million to Swiss Holderbank, one of the world's largest producers of cement. Total value of the sale of the company's cement business thus amounted to $20 million, a part of which was used to pay down debt and the balance set aside for future acquisitions.[10]

The decline in the music business was reflected in the company's steadily declining price/earnings ratio, which declined from 15 in 1969 to 1.38 in 1981, making the company a potential target for a hostile takeover.[11] According to the company's 1986 annual report, "from 1975 through 1984 Norlin reported pre-tax losses attributable to the music business of approximately $145 million, an amount equal to twice the company's net worth in 1975."[12]

According to author Patrick A. Gaughan, there are two basic types of anti-takeover defenses: passive and active. Active defenses include greenmail, which is "the payment of a substantial premium for a significant shareholder's stock in return for the stockholder's agreement that he or she will not initiate a bid for control of the company;" standstill agreements, "when the target corporation reaches a contractual agreement with a potential acquirer whereby the would-be acquirer agrees not to increase its holdings in the target during a particular time period"; and capital structure changes, including recapitalization, assuming more debt, issuing more shares or buying back shares from the potential hostile bidder, either through a self-tender, open market purchases, or targeted share repurchases, as in the case of greenmail.[13]

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[8] Norlin Corporation, *Annual Report* (1979), 22.
[9] Norlin Corporation, *Annual Report* (1976), 14.
[10] Ibid., 18.
[11] Norlin Corporation, *Annual Reports* (1969-1981): P/E ratios calculated by author.
[12] Service Resources Corporation, *Annual Report* (1986), 12.
[13] Gaughan, *Mergers, Acquisitions, and Corporate Restructurings,* 177, 181, and 189-90.

Two other popular anti-takeover defenses of the 1980s were the formation of Employee Stock Ownership Plans or ESOPs, which dilute shareholder equity and make it more difficult for a potential acquirer to purchase a controlling interest in the target company, and litigation, which is usually the first line of defense of the intended target.[14] In the fight to preserve control of Norlin the incumbent management team would employ all five active defenses.

Norlin first became the target of a possible takeover on May 19, 1981, when Camelia Investments, a British tea company controlled by Canadian businessman Gordon Fox, bought a 16 percent stake in Norlin through its Lawrie Plantations and Jatel, Ltd., subsidiaries. Norlin's management immediately sued Camelia to block further purchases of Norlin common shares.[15] In October 1981 Norlin sold off its Norlin Technology Unit to Amstar, the largest U.S. sugar producer, for $56 million.[16] On February 5, 1982, Lawrie Plantations raised its stake in Norlin to 20 percent or 394,800 shares, at prices ranging from $14.00 to $16.38 per share.[17] By March 15, 1982, Lawrie had raised its stake in Norlin to 24.03 percent. Opposition by Norlin management to a Lawrie takeover resulted in a three-year standstill agreement under which Lawrie agreed not to make further purchases of Norlin shares in return for having two of its own representatives elected to the Norlin board of directors.[18]

On December 15, 1982, Norlin sold its Latin Development Company brewery unit (LADCO) to the Colombian conglomerate Bavaria for $50 million, bringing to a close Norlin's seventy years of profitable operations in Ecuador. According to the 1982 annual report, the decision to divest the beverage unit, which accounted for 40 percent of Norlin's 1981 sales of $220.9 million and which was Norlin's only profitable unit, was prompted by the 50 percent devaluation of the Ecuadorian *sucre*.[19] It is also possible that the decision to sell off the brewery and technology units was motivated, at least in part, by a desire to make Norlin a less attractive take-over target should Camelia Investments actively pursue further purchases of Norlin's common stock in an attempt to gain control of the company.

The sale of the brewery unit prompted Lawrie Plantations, Norlin's single largest shareholder at the time, to end the three-year standstill agreement, because the brewery had been sold without the approval of Lawrie's representatives on the board of directors.[20] To rid the company of

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[14] Ibid., 60-61; 342-60.
[15] "Camelia Investments Buys 16 % Stake in Norlin," *Wall Street Journal*, 19 May 1981, B1.
[16] "Amstar Buys Norlin Technology Unit," *Wall Street Journal*, 19 Oct. 1981, B1.
[17] "Lawrie Lifts Stake in Norlin to 20%," *Wall Street Journal*, 5 Feb. 1982, B1.
[18] "Lawrie 24.3% Stake of Norlin, Agrees Not to Buy More for Three Years," *Wall Street Journal*, 18 April 1982, B1.
[19] Norlin Corporation, *Annual Report* (1982), 2.
[20] "Lawrie Ends Three Year Standstill Agreement with Norlin," *Wall Street Journal*, 23 Dec. 1982, B1.

its unwanted suitor, on March 9, 1983, Norlin paid $12.3 million in greenmail to repurchase the 474,700 shares owned by Lawrie at $26 per share, a substantial premium above the $14 to $17 per share that Lawrie had paid for its original investment.[21] The sale of the brewery and technology units raised Norlin's cash balance to $64,341,000 at the end of 1982. Norlin's tax loss carry forward of $20 million from the continuing losses on its music business further enhanced the company's attractiveness as a target for a hostile takeover.[22]

The divestiture of Norlin's technology, cement, and beverage units in Ecuador, coupled with the continuing losses from its music operations, left the company's management with no other alternative but to look for new lines of business. In October 1983 Norlin purchased Ticor Printing from the Southern Pacific Corporation for $75 million.[23]

In January 1984 Norlin became the target of a second hostile takeover bid, this time by the Rooney, Pace Group (RPG) in partnership with Piezo Electronics. Rooney, Pace was a brokerage and private investment bank specializing in initial public offerings of small, risky companies. The firm was founded in 1978 by Patrick J. Rooney and Randolph K. Pace for $60,000. In 1983 the firm raised $16 million in an initial public offering (IPO). Piezo Electronics also went public the same year with an IPO that brought in another $36 million. Flush with cash, the two firms joined forces in search of a promising acquisition target.[24]

On January 16, 1984, Norlin accused Rooney, Pace and Piezo Electronics of making an illegal tender offer and asked the court to grant a restraining order preventing them from acquiring additional shares of Norlin common stock. In the filing Norlin charged that "Rooney, Pace pursued an unrelenting purchasing program of Norlin Common, acquiring 37 percent of Norlin's outstanding shares, including 24 percent" in a single day. RPG's strategy was to gain control of Norlin before disclosing its purchases of 5 percent or more of Norlin's shares as required by Security nd Exchange Commission ruling 13D. According to the *Wall Street Journal*, RPG paid $36 per share, a premium of $28 per share over the market price. RPG and Piezo had acquired 37 percent or 563,000 of the 1,534,690 of the common shares outstanding.[25]

On January 23 the Federal District Court in New York denied the temporary restraining order sought by Norlin, freeing RPG and Piezo to continue purchasing Norlin shares on the open market.[26] In a desperate

[21] "Norlin Acquiring 474,000 Shares from Lawrie, 24.4%, for $12.3 Million," *Wall Street Journal*, 9 March 1983, B1.
[22] Norlin Corporation, *Annual Report* (1982), 11.
[23] "Norlin Purchases Ticor Printing from Southern Pacific for $75 Million," *Wall Street Journal*, 26 Oct. 1983, B1.
[24] "Incompetence, Inc.," *Forbes* (1 Dec. 1986), 40-41.
[25] "Norlin Files Suit Against Rooney, Pace," *Wall Street Journal*, 16 Jan. 1984, B1.
[26] "Norlin Fails to Block Rooney, Pace Group from Buying Additional Shares," *Wall Street Journal*, 23 Jan. 1984, B1.

attempt to dilute the hostile bidders percentage of their stock, Norlin issued an additional 800,000 shares of $25 par value preference shares to its Andean Enterprises subsidiary and transferred another 185,000 new shares to its newly created employee stock ownership plan, or ESOP.[27]

On February 13, 1984, the *Wall Street Journal* announced that RPG and Piezo had raised their stake of Norlin common shares to 47.6 percent. Norlin management argued, however, that the hostile stake represented only 42.3 percent after the issuance of the nearly one million new shares. RPG and Piezo filed a counter suit in Federal court ordering Norlin to rescind the issuance of the new shares.[28] On March 16 the New York Stock Exchange delisted Norlin, charging that a change in control had taken place "without prior notification to shareholders," and that the issuance of the new preference shares violated the exchange's listing criteria for public ownership of stock.[29]

On April 17, 1984, Judge David Edelstein ruled against Norlin, arguing that the issuance of a new class of preference stock and the transfer of additional shares to a Norlin ESOP represented "a blatant, bad faith attempt to entrench Norlin management."[30] Norlin then filed an appeal of Judge Edelstein's ruling with the Federal District Court of Manhattan. On June 27 the Second Court of Appeals affirmed the lower court's ruling that Norlin be prevented from voting the shares held by Andean Enterprises and its ESOP and ruled that the 726,200 shares owned by RPG and Piezo amounted to a 47 percent stake in the ownership of Norlin, thus effectively granting control of the company to the hostile bidders. In the court's unanimous opinion, Judge Irving Kaufman ruled that the business judgment rule "did not allow activities that were nothing more than a tool of management self-perpetuation." Judge Kaufman noted further that "the directors offered no rationale to shareholders other than to oppose at all costs, the threat to the company."[31]

In compliance with the court's order, Norlin canceled the issuance of 800,000 preference shares and 28,395 common shares to its Andean Enterprises subsidiary and the 185,000 common shares previously issued to its employee stock ownership plan.[32] On August 9, 1984, Norlin abandoned its fight against RPG and Piezo and surrendered control of the company. The court also ordered Norlin to pay $1.2 million for legal and

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[27] "Norlin Acts to Block Rooney, Pace Group," *Wall Street Journal*, 26 Jan. 1984, B1.

[28] "Norlin Hostile Holders Stake Rises to 47.6%," *Wall Street Journal*, 13 Feb. 1984, B1.

[29] "NYSE to Delist Norlin," *Wall Street Journal*, 16 March 1984, B1.

[30] "Federal Judge Enjoins Norlin from Voting Its Shares," *Wall Street Journal*, 17 April 1984, B1.

[31] "Federal Appeals Court Affirmed Lower Court's Ruling," *Wall Street Journal*, 29 June 1984, B1.

[32] "Norlin Cancels Shares It Gave to Unit to Thwart Two Investors," *Wall Street Journal*, 12 July 1984, B1.

solicitation fees incurred by the hostile bidders. At the September 6 meeting of the board of directors, Randolph K. Pace was named chairman of Norlin to succeed H. Norton Stevens, who was demoted to vice-president of the company that his family had controlled for over seventy years.[33]

On assuming the chairmanship, Pace announced his intention of phasing out the musical instrument business to concentrate exclusively on the Ticor printing business—a business, one might add, in which Rooney, Pace had no prior experience. According to Norlin's new CEO, the Norlin corporation had been selected as a target for takeover because "we felt that Norlin was an undervalued situation with assets that could be better used, and could lead to better capital appreciation."[34]

On October 5, 1984, Norlin sold the Lowrey organ business for $11 million in cash and securities, and wrote down an additional $7 million of the music business.[35] To preserve its $24 million in tax loss carry forward, Rooney, Pace partner Piezo Electronics sold 300,000 of the 363,100 common shares it owned in Norlin.[36] Norlin's Gibson guitar unit was finally sold off in January 1986 for $5 million; the proceeds of the sale were used to pay the interest due on the old ECL Industries 9 percent debentures that had been issued to finance the purchase of the Chicago Musical Instrument Company.[37]

When H. Norton Stevens resigned from Norlin's board of directors on March 5, 1985, the final link between the company and its origin in Ecuador was severed. But Norton Stevens was to have the ultimate revenge, as the hostile takeover of his and his grandfather's company would ultimately bring down the Rooney, Pace Group as well.

Barely two weeks after Norton Stevens' resignation, the new management announced that it would sell the financial printing operation originally purchased from Ticor and use the proceeds to pay off long-term debt.[38] Randolph Pace, Norlin's CEO, was charged with securities laws violations in the 1981 sale of $12 million of Sequential Information Systems shares when he headed up the brokerage operations of the Rooney, Pace Group.[39] From this point the business affairs of Rooney, Pace and Norlin began rapidly to unravel.

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[33] "Norlin Names Randolph K. Pace Chairman after Group Takes Control," *Wall Street Journal*, 10 Sept. 1984, B1.
[34] Ibid.
[35] "Norlin Sells Assets, Sets Write Down," *Wall Street Journal*, 5 Oct. 1984, B.1.
[36] "Fourth Q Loss of Norlin," *Wall Street Journal*, 20 Dec. 1984, B.1.
[37] "Norlin Completes Sale of Gibson Guitar Unit," *Wall Street Journal*, 17 Jan. 1986, B1.
[38] "Norlin Explores Sale of Part of Subsidiary," *Wall Street Journal*, 26 March 1985, B1.
[39] "Rooney, Pace Chief to Appeal SEC Charge that He Violated Securities Laws," *Wall Street Journal*, 4 June 1985, B1.

On October 31, 1985, Norlin was forced to refinance $22 million of its 9 percent debentures due in 1988 and 1989 for 11 percent debentures due in 1994, leading its auditor Deloitte, Haskins and Sells to issue a "going concern" qualification, stating that "the company's ability to continue as a going concern cannot be determined with certainty as it is dependent on future events."[40] On November 7, 1985, Norlin's stock price dropped to $1.62 per share, and a month later Rooney, Pace announced the sale of its 24 percent interest in Norlin. The Norlin logo ceased to exist on March 10, 1986, when the company's name was changed to Service Resources Corporation. The Rooney, Pace brokerage was finally closed on January 16, 1987, and on May 26, 1988, Patrick J. Rooney was convicted of 1983 income tax fraud and sentenced to jail for income tax evasion. Service Resources Corporation went through another name change to Ameriscribe Corporation on March 24, 1990, and was finally bought out for $83 million by the European firm Pitney Bowes on April 23, 1993.

*Forbes* magazine best summed up the takeover battle between Norlin and the Rooney, Pace Group in an article on December 1, 1986, entitled "Incompetency Inc." According to *Forbes*, Rooney, Pace's acquisition of "Norlin also proved to be the wedge that drove the two partners apart. . . . Not taking time to study his potential prey, Rooney went after Norlin . . . and paid an average of $32.50 per share . . . causing a total loss of $10.5 million of their original investment."[41]

Although Norlin itself disappeared in 1985 when the name of the company was changed to Service Resources Corporation, the businesses that Evermont Hope Norton had developed in Ecuador continued to thrive. The cut flower industry, originally developed by the Ecuadorian Corporation, is today one of the top export earners for the country. In a survey conducted in 2002 by the Ecuadorian business journal *Gestión*, the National Cement Company, now owned by Swiss Holderbank, and the National Brewery, now wholly owned by SAB-Miller, were both in the list of the top ten companies in Ecuador as measured by both capital investment and profits.[42]

The root cause of the demise of the Norlin Corporation must be sought in the fateful decision made by Norton Stevens and his board of directors to divest the company's operations in Ecuador and to acquire entirely new lines of business in electronics, music, and printing, all areas in which the Norlin executives had no prior experience. The most damaging criticisms of Norlin's management came in regard to the 1969 acquisition of the Musical Instrument Company: it "immediately filled its management

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[40] Service Resources Corporation, *Annual Report* (1986).
[41] "Incompetence, Inc.," *Forbes* (1 Dec. 1986), 40-41.
[42] "25 de *Gestion*: Mayores Inversiones y Mayores Ganadores de Dinero," *Gestion: Economia y Sociedad* 96 (June 2002): 17.

ranks with MBAs who had no previous experience with musical instrument design and manufacture."[43]

The Norlin claim that the Cuban revolution was the main reason for divesting the company's operations in Ecuador does not withstand serious scrutiny. Although Norlin's acquisitions in high technology and musical instrument manufacture were all completed by 1969, the company's Ecuadorian subsidiaries were not sold until 1975 and 1982, and, as described earlier, they continue to earn profits for their current owners.

Another factor worthy of consideration is the hubris hypothesis, developed by Richard Roll to explain the motives of the management of the acquiring firm in hostile takeovers.[44] Although impossible to prove empirically, Norton Stevens may have been motivated, at least in part, by a desire to surpass his grandfather. Perhaps the Ecuadorian Corporation's steady but low rate of growth in income and net profit was not enough to satisfy the ambitions of a young Norton Stevens fresh out of graduate school and the favorite grandson of Evermont Hope Norton.

The most plausible explanation for Norlin's destruction lies in economic factors that were beyond the control of both Norlin and Rooney, Pace. The recession that began in 1975 led ultimately to the bankruptcy of the company by 1981. The other contributing factor was the hubris and incompetence of the Rooney, Pace Group, in assuming that they could take over the management of a company operating in areas in which they had no previous operational experience.

Patrick A. Gaughan in his 1996 book *Mergers, Acquisitions and Corporate Restructurings* presents two opposing views of the hostile takeover: the "management entrenchment hypothesis" and the "stockholder interests' hypothesis." According to Gaughan,

> when managers of a corporation seek to maintain their position by actions such as greenmail or the institution of other active and preventative corporate defenses, stockholders experience reduced wealth when management takes actions to deter attempts to take control of the corporation.[45]

Although it is clear from the facts presented in this case study that there were no winners in the hostile takeover of the Norlin Corporation, it is nevertheless difficult to agree with the court's ruling based on the business judgment rule and the management entrenchment hypothesis that granting control of Norlin to the Rooney, Pace Group benefited the stockholders of either group.

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43 "Maestro PS-1A Phase Shifter," http://www.winspreadrecords.com/maestro_20psl_page.html.

44 Gaughan, *Mergers, Acquistions, and Corporate Restructurings,* 136-38.

45 Ibid., 152-53.